No. 14631

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

In the Matter of

HARRY SMITH MACHINE COMPANY, a California corporation,

Debtor.

SAMUEL A. MILLER and MASON & WALLACE,

Appellants.

APPELLANTS' OPENING BRIEF.

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TOPICAL INDEX

TABLE OF AUTHORITIES CITED

Statutes

Textbook

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Appeal and Jurisdiction.

This appeal is taken under Section 24 of The Bankruptcy Act of 1938 as amended, to reverse an Order of the District Court [Tr. of Rec. pp. 32 and 33]. That Order, on Review, affirmed a Referee's Order [Tr. of Rec. pp. 25 and 26] allowing attorney's fees in the sum of Thirty-five Hundred ($3,500.00) Dollars to the appellants as attorneys for the debtor, but fixing the status and order of payment of said amount as "ranking equally with the debts to unsecured creditors covered by the Order Confirming Arrangement of June 9, 1954" [Tr. of Rec. p. 26].

Basis of and Points on Appeal.

There are three grounds upon which this appeal is based. Stated in another way there are three questions to be determined on appeal. They are questions of law only, as the facts are undisputed.

Those questions are:

1. Did the Referee in Bankruptcy, Honorable David B. Head, err after making his Order of August 10, 1954 [Tr. of Rec. pp. 25 and 26] allowing appellants the sum of Thirty-five Hundred ($3,500.00) Dollars as attorneys for the debtor, which amount the appellants indicated could be evidenced by a note of the debtor payable in twelve equal installments provided that such sums when paid be one of the costs and expenses of administration and be a lien on the assets of the debtor corporation until paid [Tr. of Rec. pp. 19 to 24, incl.] when the Referee provided in said Order [Tr. of Rec. pp. 25 and 26]

> "that said note rank equally with the debts to unsecured creditors covered by the Order Confirming Arrangement of June 9, 1954" [Tr. of Rec. pp. 16 to 18, incl.].

2. Does it not follow as a matter of law that such sum of money as may be allowed to attorneys for a debtor who were appointed such under an appropriate Order of the Referee [Tr. of Rec. p. 5] is entitled to priority and is payable as one of the costs and expenses of administration as provided by Section 64a(1) and Section 337(2) of The Bankruptcy Act?

3. Did the Referee err in sending out notice of meeting of creditors dated July 19, 1954 [Tr. of Rec. p. 25] "to hear application for allowance to Samuel A. Miller

and Mason & Wallace as attorneys for the debtor" when he failed to include in said notice (if indeed it was legally necessary for him to do so) a provision that any amount to be allowed be a lien upon the assets of the estate of the debtor by reason of the priority of the claim for attorney's fees as provided by Section 64a(1) of The Bankruptcy Act and by Section 337(2) of The Bankruptcy Act?

The foregoing grounds of appeal or questions on appeal will be amplified by the appellants' statements of points and authorities to be relied upon in this appeal and as are hereinafter set forth.

Statement of Facts.

On March 10, 1954, debtor filed an original petition under Section 322, without schedules, and on March 26, 1954, the above named debtor filed the original plan for arrangement under Section 322 of The Bankruptcy Act [Tr. of Rec. pp. 6 to 13, incl.]. On April 13, 1954, the debtor filed an amendment to Petition for Arrangement under Section 322 [Tr. of Rec. pp. 14 and 15].

On March 23, 1954, the appellants herein as attorneys for the debtor filed a petition on behalf of the debtor for their appointment as attorneys for the debtor [Tr. of Rec. pp. 3 to 5, incl.], and on March 23, 1954, the Referee signed an Order [Tr. or Rec. p. 5] appointing the appellants herein as the attorneys for the debtor in possession, said appointment being "under a general retainer" and providing that "they shall be compensated for their services out of the estate of the debtor."

Thereafter the usual and customary proceedings were had as in other petitions for arrangements under Section 322, resulting in an Order Confirming Arrangement [Tr. of Rec. pp. 16 to 18, incl.], dated June 9, 1954.

After the signing of the Order Confirming Arrangement [Tr. of Rec. pp. 16 to 18, incl.] and *after* it was ascertained that the creditors were willing to accept the plan and the amendment to the plan offered by the debtor, and *after* the Order Confirming Arrangement [Tr. of Rec. pp. 16 to 18, incl.] was signed, the appellants herein, on June 28, 1954, filed their "Petition for Allowance to Attorneys for Debtor" [Tr. of Rec. pp. 19 to 24, incl.]. Thereafter and on July 19, 1954, the Referee sent a notice pursuant to Section 58, Subdivision 8 of The Bankruptcy Act of a meeting of creditors [Tr. of Rec. p. 25] to hear the application for allowance, which meeting was held on July 29, 1954, at which time no creditor or other person in interest appeared to object to the amount of the allowance or to make any other objection in connection with the appellants' petition for allowance, and at which meeting the debtor did not appear to object nor has the debtor objected at any time to the amount requested in allowance as attorneys for the debtor (or that such amount be a lien on its assets), and also at which time the Referee took the matter of the application for allowance under submission, and on August 10, 1954, the Referee made an Order of Allowance to the attorneys for the debtor (the appellants herein) [Tr. of Rec. pp. 25 and 26], being the Order which in part led to the Petition for Review and to this appeal, the objectionable part of the Order being that part which fixed the status of the fees to the attorneys for the debtor (the appellants herein) indicating that the attorney's fees would "rank equally with the debts to unsecured creditors covered by the Order Confirming Arrangement of June 9, 1954."

Appellants believe that the foregoing represents and constitutes a fair statement of the facts of this case lead-

ing up to the Review to the District Court of the Referee's Order and leading up to and being the basis of the appeal herein.

Statement of Law on Points Involved and Arguments Thereon.

Point 1. Did the Referee in Bankruptcy err after making his Order of August 10, 1954, allowing appellants the sum of Thirty-five Hundred ($3,500.00) Dollars as attorneys for the debtor, which amount the appellants indicated could be evidenced by a note of the debtor payable in twelve equal installments provided that such sum when allowed be one of the costs and expenses of administration and be a lien on the assets of the debtor corporation until paid, wherein in said Order it was provided with reference to the allowance:

> "That said note rank equally with the debts to unsecured creditors covered by the Order Confirming Arrangement of June 9, 1954."

In submitting the law on the points raised on this appeal as hereinabove set forth, reference is first made to that part of the Petition for Arrangement under Section 322 starting with Subdivision IIIA thereof [Tr. of Rec. pp. 6 and 7] reading as follows:

> "A. The debts of your petitioner to be affected by this plan of arrangement shall be as follows:
>
> 1. All debts which have priority under Section 64a (1), (2) and (4) of The Bankruptcy Act.
>
> "B. The debts of your petitioner as above set forth shall in this plan of arrangement be treated as follows:
>
> 1. All debts included in Class A(1) are to be paid in cash in full upon the signing of the Order of

Confirmation of the plan, or to be paid at such time and in such installments as may be agreed upon by and between your petitioner and the various Taxing Agencies having claims coming within this class of indebtedness."

Section 64a(1) reads as follows:

"Section 64. Debts Which Have Priority.

"a. The debts to have priority, in advance of the payment of dividends to creditors, and *to be paid in full* out of bankrupt estates, and the order of payment, shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; etc., etc., and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases and to the bankrupt in voluntary and involuntary cases, as the Court may allow." (The italics above does not appear in the text but is used for emphasis.)

The foregoing has to do with attorney's fees in straight bankruptcy matters and is included in Chapters I to VII of The Bankruptcy Act.

Section 302 under the title of Arrangements, Chapter XI provides as follows:

"Section 302. The provisions of Chapter I to VII inclusive, of this Act, shall, insofar as they are not inconsistent or in conflict with the provisions of this Chapter, apply in proceedings under this Chapter. For the purposes of such application, provisions relating to 'bankrupts' shall be deemed to relate also to 'debtors' and 'bankruptcy proceedings' or 'proceedings in bankruptcy' shall be deemed to include proceedings under this Chapter, etc., etc."

Section 337, subdivision 2, reads as follows:

"Section 337. At such meeting, or at any adjournment thereof, the Judge or Referee shall, after the acceptance of the arrangement—

"(2) Fix a time within which the debtor shall deposit, in such place as shall be designated by and subject to the Order of the Court, the consideration, if any, to be distributed to the creditors, *the money necessary to pay all debts which have priority, unless such priority creditors shall have waived* their claims or *such deposit,* or consented in writing to any provision of the arrangement for otherwise dealing with such claims, and the money necessary to pay the costs and expenses of the proceedings, and the necessary expenses, in such amount as the Court may allow, etc., etc." (The italics does not appear in the text but is used for emphasis.)

It follows from the citations of Section 64a(1) (United States Code, Title 11, Chap. 7, Sec. 104) and Section 302 of The Bankruptcy Act (United States Code, Title 11, Secs. 701-709) that whatever applies to attorneys for "bankrupts" likewise applies to attorneys for "debtors," and that therefore if an attorney for a bankrupt were entitled to be paid in full such reasonable amount as the Court would allow for services rendered to the bankrupt, the attorneys for a debtor would likewise be entitled to be compensated in full out of the assets of the estate to the extent of such an amount as the Court would find to be reasonable.

In this proceeding the Referee had found the amount to be paid as reasonable was in the sum of Thirty-five Hundred ($3,500.00) Dollars and, of course, the only quarrel that the appellants have is with the quoted portion of the Order appealed from, namely, that the payment

"rank equally with the debts to unsecured creditors covered by the Order Confirming Arrangement of June 9, 1954" [Tr. of Rec. pp. 16 to 18, incl.].

In 8 Collier on Bankruptcy at pages 540 and 541, and under Section 337(2), which is quoted hereinabove, it is clear that a deposit is unnecessary if the deposit is waived, and in this instance the appellants herein waived the deposit by their expressed willingness to accept the debtor's note in twelve equal monthly installments provided only that the amount allowed should be "a lien" upon the assets of the debtor, as set forth in their Petition for Allowance [Tr. of Rec. p. 23]. It may be well at this point to point out to this Honorable Court that the appellants herein, as stated in their Petition for Allowance [Tr. of Rec. p. 23]

> "were mindful of the fact that the debtor might not have the present ability to pay such amount as would be allowed by the Court to them as attorneys for the debtor and were willing to accept the note of the debtor corporation to be paid in twelve equal monthly installments with interest at six percent and which sum, when allowed, being one of the costs and expenses of administration, shall be a lien upon the assets of the debtor corporation until paid."

The Referee in his Certificate on Review [Tr. of Rec. pp. 29 to 31, incl.] stated as follows:

> "Any priority the petitioners could have asserted under Section 64a(1) or 337(2) of The Bankruptcy Act, was waived by not presenting their petition before confirmation so that the Court could have required a deposit sufficient to cover any allowance." (Citing 8 Collier, 567.)

The Honorable Referee seems to have lost sight of the fact that appellants waived their right to a deposit as pro-

vided under Section 337(2) by their expressed willingness to accept the note payable in twelve equal monthly installments, provided only that the amount allowed should be "a lien" upon the assets of the debtor.

The Referee further stated in his Certificate on Review that the Order of Confirmation [Tr. of Rec. pp. 16 to 18, incl.] in part read as follows:

> "IT IS FURTHER ORDERED, that *the debtor shall not* further encumber its present assets until all other creditors have been paid in full, *or in the alternative, without first advising the creditors of its intention to further encumber its present assets.*" (The italics does not appear in the quoted portion of the Order but is used for emphasis.)

The Referee further states in his Certificate on Review "The petitioners (being the appellants herein at this time) have asked me to do what I had restrained the debtor from doing."

The Honorable Referee seems to have lost sight of the fact that what your appellants had asked the Referee to do in order to be helpful to the debtor, to wit, to make the promissory note which your appellants agreed to take, "a lien" upon the debtor's assets, he could do and had a legal right to do, although the debtor did not have the right to do so without "first advising the creditors of its intention to further encumber its present assets," as was provided in the Order of Confirmation.

The notice to the creditors that the "present assets" of the debtor were to be "further encumbered" by "the lien" was a notice that the debtor had to give, but certainly not the Court, if the debtor wanted to further encumber its assets.

A notice to creditors of the Petition for Allowance went out to all creditors. This notice was sent out under the supervision and direction of the Referee and was under the control of the Referee and was not under the supervision, direction or control of the appellants herein or the debtor herein and the Referee could have and should have stated in that notice the request of your appellants for the "lien upon the assets" of the debtor if the Court felt that such notice was required and that the amount to be allowed to your appellants should be paid in full as a priority claim, which is in accordance with the law as set forth in Section 64a(1) of The Bankruptcy Act, Section 302 of The Bankruptcy Act and Section 337(2) of The Bankruptcy Act.

It would seem from the foregoing that the second point involved in this appeal is also disposed of in that attorneys who were appointed such for a debtor under an appropriate Order of the Referee are entitled to priority and to be paid in full as a cost and expense of administration such amount as may be allowed to them as reasonable attorney's fees.

And it further follows that Point 3 is disposed of in that it clearly appears that if under the Order of Confirmation the assets of the debtor corporation were not to be further encumbered "until all other creditors have been paid in full, *or in the alternative without first advising the creditors of its intention to further encumber its present assets.*" (The italics does not appear in the quoted portion of the Order but is used for emphasis.) That the

Referee erred when he sent out the notices of the meeting of creditors dated July 19, 1954 [Tr. of Rec. p. 25] when he failed to insert and include in said notice (the sending of which was solely and exclusively under his control) a provision "that any amount to be allowed by the Referee shall be a lien upon and a further encumbrance upon the assets of the debtor by reason of the priority of the claim for attorney's fees as a cost and expense of administration as provided by 'The Bankruptcy Act.'"

Your appellants have been unable to find any cases on the points involved in this appeal and have had to rely solely upon logic and a reasonable interpretation of the Sections of The Bankruptcy Act referred to and the references in Collier on Bankruptcy, and it appears to the appellants that it is not consistent with The Bankruptcy Act to expect attorneys who have come into existence as attorneys for a debtor under an appropriate Order of the Court after the filing of the debtor proceedings, to render services to the debtor in the bankruptcy proceedings and then have those services compensated for on the basis of a general unsecured creditor whose claim was in existence at the date of bankruptcy or at the date of the Order of Confirmation.

If the Order of the Referee that the amount to be allowed to your appellants, which the Court has apparently found to be a reasonable amount, shall rank equally with the debts to unsecured creditors covered by the Order Confirming Arrangement of June 9, 1954 [Tr. of Rec. pp. 16 to 18, incl.], then it appears that your appellants

are being penalized by the Order of the Referee, in that your appellants are being required to render services and to continue to render services for a period of eight months after the 9th day of June, 1954, as the Order Confirming Arrangement [Tr. of Rec. p. 17] provides "That the Court shall retain jurisdiction for a period of eight month from the date hereof for all purposes," for compensation equivalent to the amount to be paid to unsecured creditors in the event of liquidation, which is certainly a situation not contemplated by The Bankruptcy Act, and expecially Section 64a(1), 302 and 337(2).

It is respectfully urged that by reason of the foregoing that the Order of the Honorable James M. Carter dated November 16, 1954 [Tr. of Rec. pp. 32 and 33], affirming the Referee's Order denying priority of payment of allowance to attorneys for the debtor be reversed and the Honorable District Judge be directed to order the Referee to send out a new notice to creditors (if indeed a new or different notice is required), in which notice to creditors it shall clearly set forth that it is the intention of the Referee to encumber the assets of the debtor to the extent of the amount of attorney's fees allowed by the Court to be reasonable and in the sum of Thirty-five Hundred ($3,500.00) Dollars.

It is further urged that it would be inequitable to expect your appellants as the attorneys for the debtor, who have already rendered substantial services for which the Court has made an allowance of Thirty-five Hundred ($3,-500.00) Dollars as being the reasonable value of the serv-

ices, to be paid that sum of Thirty-five Hundred ($3,500.00) Dollars on a pro rata basis in the event that the debtor's plan of arrangement should ultimately fail and an order of liquidation be made by the Referee as provided by Section 377 of The Bankruptcy Act, and to find themselves in the same class of general unsecured creditors whose claims were incurred prior to the filing of the debtor proceedings herein and to be paid, if at all, such dividends as would be realized from a liquidation of the assets of the debtor on hand at the date of liquidation.

Respectfully submitted,

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